DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS NUMBER 98-0242
INDIANA CORPORATION INCOME TAX
For the Tax Years 1992, 1993, 1994, and 1995

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ISSUES

I. Apportionment of Taxpayer's 1992 Indiana Source Income.

Authority: IC 6-3-2-2(b); IC 6-3-2-2(l); 45 IAC 3.1-1-62.

Taxpayer protests the audit's determination that a casualty loss, experienced at taxpayer's Indiana business location, should be included within the standard apportionment formula. Taxpayer argues that the circumstances under which taxpayer experienced the casualty loss, along with the purported distortion of the taxpayer's 1992 adjusted gross income, warrants an alternative method of apportioning the taxpayer's Indiana source income.

II. Abatement of the Ten-Percent Negligence Penalty.

Authority: 45 IAC 3.1-1-62; 45 IAC 15-11-2(b); 45 IAC 15-11-2(c); IC 6-3-1-3.5(b); IC 6-3-2-2.6; IC 6-8.1-10-2.1(a); IC 6-8.1-10-2.1(d).

Taxpayer requests that the Department exercise its discretionary authority to abate the ten-percent negligence penalty. A certain portion of the penalty is based upon the taxpayer's original method of apportioning its 1992 income and the taxpayer's decision to carry forward a portion of the loss attributable to 1992 into subsequent years. Taxpayer maintains that its original decision to carry forward the 1992 losses was a reasonable and that abatement of the penalty is warranted.

STATEMENT OF FACTS

Taxpayer is in the hotel and lodging business. Taxpayer operates hotels in various states including a single hotel located in the state of Indiana. The taxpayer's headquarters is located in Missouri. Taxpayer originally protested the audit's determination that losses incurred at its Indiana business site should be included in the apportionment factor for determining taxpayer's adjusted gross income. The original Letter of Findings agreed

with audit's determination. The taxpayer was granted the opportunity for a rehearing. This Supplemental Letter of Findings revisits the issue.

DISCUSSION

I. Apportionment of Taxpayer's 1992 Indiana Source Income

In February of 1992, the taxpayer's Indiana business location was the site of a military airplane accident. The airplane accident resulted in substantial damage to the taxpayer's property. As a result, the taxpayer stopped receiving Indiana source income from that site. After the taxpayer completed the reconstruction of its business property and after the taxpayer recovered all related insurance proceeds, the taxpayer sustained a casualty loss of $491,177.

The original Letter of Findings determined that the casualty loss was properly classified as ordinary business casualty loss and not – as taxpayer originally maintained – a "non-business" casualty loss otherwise attributable entirely to the state of Indiana. Taxpayer does not dispute the original determination that the 1992 $491,177 casualty loss was "business" in nature. What the taxpayer does contest is the Department's proposed apportionment of Indiana income for the tax year ending December of 1992.

Taxpayer receives business income from sources within the state of Indiana and outside the state. Accordingly, in calculating its adjusted gross income, taxpayer falls within the provisions of IC 6-3-2-2(b), which states that:

> [I]f business income of a corporation or a nonresident person is derived from sources within the state of Indiana and from sources without the state of Indiana, then the business income derived from sources within this state shall be determined by multiplying the business income derived from sources both within and without the state of Indiana by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three (3).

In effect, the taxpayer does not want the 1992 $491,177 casualty loss, experienced at its Indiana business site, subjected to the apportionment provisions of IC 6-3-2-2(b) but wants the loss to "stay" exclusively within Indiana. Taxpayer believes that it falls within the provisions of 45 IAC 3.1-1-62 – promulgated pursuant to IC 6-3-2-2(l) – which allows a taxpayer to depart from the standard allocation and apportionment provisions under certain unique circumstances. That regulation states that such a departure is warranted when the standard apportionment provisions "do not result in a division of income which fairly represents the taxpayer's income from Indiana sources." Id.

The standard established for allowing the taxpayer to claim the regulatory exception is high. 45 IAC 3.1-1-62 directs that "the Department will depart from use of the standard formula only if the use of such formula works a hardship or injustice upon the taxpayer, results in an arbitrary division of income, or in other respects does not fairly attribute

income to this state or other states. It is anticipated that these situations will arise only in limited and unusual circumstances (which ordinarily will be unique and nonrecurring) when the standard apportionment provisions produce incongruous results."

Taxpayer has set forth a compelling argument that the 1992 aircraft accident brings it within the purview of 45 IAC 3.1-1-62. Indeed, it can be fairly argued that an Air National Guard C-130 crashing into and destroying taxpayer's Indiana business location does create a scenario which "will arise only in limited and unusual circumstances." 45 IAC 3.1-1-62. However, the precise circumstances under which taxpayer experienced the business loss – no matter how tragic or unique those circumstances may be – are not determinative of the issue. In the analytical language of the tax code, taxpayer experienced a casualty loss. Divorced from the singular circumstances under which the particular loss was sustained, taxpayer's business loss is indistinguishable from the loss occasioned by a fire, a flood, a highway relocation, or simply a particularly bad business cycle.

FINDING

Taxpayer's protest is respectfully denied.

II. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer has requested that the ten-percent negligence penalty, imposed under the authority of IC 6-8.1-10-2.1(a), be abated for the taxpayer's additional income tax liabilities assessed during the tax years 1992, 1993, 1994, and 1995. Taxpayer maintains that any mistakes it made, with regard to its income tax liabilities, were made in good faith and were not the result of taxpayer's negligence.

IC 6-8.1-10-2.1(d) states that if a person, subject to the negligence penalty, imposed under IC 6-8.1-10-2.1(a), can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the Department, was due to reasonable cause and not due to willful neglect, the Department shall waive the penalty. 45 IAC 15-11-2(b) defines "negligence" as the failure to use the "reasonable care, caution, or diligence, as would be expected of an ordinary reasonable taxpayer." Negligence results from a "taxpayer's carelessness, thoughtlessness, disregard, or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations." Id.

In order to waive the negligence penalty, the taxpayer must demonstrate that its failure to pay the full amount of tax due was due to "reasonable cause." 45 IAC 15-11-2(c). Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ." Id. In determining whether reasonable cause exists, the Department may consider the nature of the tax involved, previous judicial precedents, previous Department instructions, and previous audits. Id.

After taxpayer originally determined that it had incurred a business loss during 1992, it carried a portion of that loss forward to taxpayer's 1993 and 1994 tax returns. The audit determined that this decision was inappropriate and disallowed the carryforward of the 1992 loss. Taxpayer maintains that it based its initial decision to carry forward the losses on IC 6-3-2-2.6. According to taxpayer, IC 6-3-2-2.6 permits taxpayer, as a nonresident corporation, a deduction and a carryfoward for net operating losses pursuant to I.R.C. § 172. In addition, taxpayer predicated its decision to carry forward the 1992 losses under the provisions of IC 6-3-1-3.5(b) which instructs corporations to begin computing their Indiana income based upon the definition of "taxable income" as contained within I.R.C. § 63.

Taxpayer's analysis of the Indiana and Internal Revenue Code remains obscure, and the Department believes that taxpayer's specific application of the cited provisions is entirely unwarranted. However, regardless of the Department's ultimate treatment of the taxpayer's 1992 casualty loss, under IC 6-8.1-10-2.1(d), taxpayer has established that its initial decision to allocate its 1992 business loss to Indiana under the provisions of 45 IAC 3.1-1-62 and to carry forward that 1992 loss to its 1993 and 1994 tax returns was due to "reasonable cause and not due to willful neglect . . . ." However erroneous those decisions may have been, taxpayer, by its interpretation and application of the relevant statutes and regulations, has demonstrated that it exercised "ordinary business care" in determining that it could allocate and carry forward the 1992 loss. 45 IAC 15-11-2(c). Accordingly, to the extent that taxpayer was subjected to the ten-percent negligence based upon the errors it made in its 1993 and 1994 returns, the Department is obligated to abate that penalty under IC 6-8.1-10-2.1(d). However, because the penalty attributable to 1992 was only partially based upon taxpayer's decision to allocate its business loss to Indiana, the Department does not have a sufficient basis upon which to justify abating the 1992 negligence penalty.

The audit determined that taxpayer had underreported its 1995 income. Taxpayer maintains that it believed that, under IC 6-3-1-3.5(b), it had properly reported its 1995 taxable income as defined under § I.R.C. 63. However, unlike the facts surrounding the preparations of its 1993 and 1994 returns, taxpayer has presented no substantive evidence demonstrating that it exercised the requisite "reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." 45 IAC 15-11-2(b). The Department may not abate the negligence penalty based upon the taxpayer's bare assertion that it believed it was correctly reporting its 1995 taxable income.

FINDING

Taxpayer's protest is denied in part and sustained in part.

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